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AUGUST 1949

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CHICAGO HOUSING AUTHORITY

This Project is part of the
Low Rent Housing Program of the
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CHICAGO HOUSING AUTHORITY

BUSINESS CONDITIONS
A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Grain Storage Capacity Inadequate

Situation Intensified by Price Supports

Available grain storage capacity is inadequate to handle the large volume of grain production realized in recent years. The acute shortages experienced last fall are present again. A number of factors, including the large carry-over of grains, indicated near-record production this year, and prospects for some decline in export volume, combine to create a record demand for grain storage capacity. The situation is further intensified by efforts to maintain grain prices at relatively high levels.

LARGE SUPPLIES ON HAND

July 1 carry-over of grain from the previous year's crops was unusually large, in excess of two billion bushels, more than double the year-ago amount. The major part of the increase was accounted for by corn with stocks estimated at 1,277 million bushels, the largest on record for July 1 and nearly three times the relatively small stocks of a year ago.

Oats stocks were also at record levels, 60 per cent above a year ago, and barley inventories were the largest for any year except 1943. Combined holdings of corn, oats, and barley—the three leading feed grains—totaled 43 million tons, two and one-half times the July 1 total a year earlier and a record high.

Wheat carry-over from the 1948 crop was 293 million bushels, the largest since 1944. In addition, the carry-over of flaxseed, soybeans, and grain sorghum was larger than last year and mostly above average. Corn production this year (July 1 condition) is indicated at 3,530 million bushels. The carry-over from the 1948 crop (October 1) probably will be at least 750 million bushels making a total supply of about 4,280 million bushels. This is 15 per cent more than the record 1948-49 supply for which storage was generally inadequate. Oat and barley production (July 1 indication) apparently will be less than in 1948 by about seven per cent for oats and 23 per cent for barley.

The wheat harvest, nearing completion, is estimated at 1,189 million bushels. This, with the carry-over from 1948, would provide a total supply for 1949-50 of about 1,482 million bushels, a near-record volume and about equal to a year ago.

Flaxseed production is indicated at 10 to 15 per cent less than in 1948, but a large carry-over will maintain storage requirements for this crop at a high level. Planted acreage of soybeans is six per cent less than a year ago, but growing conditions are as favorable as last year.

Although indications are that production of most grain crops this year will be somewhat less than in 1948, the larger inventories carried forward from preceding crops will result in total supplies and storage requirements comparable to 1948. It is possible, of course, that

final 1949 production may be materially more or less than the amounts indicated here depending upon growing and harvesting conditions to the end of the season, particularly for corn.

Exports of grain set a new record in the year ended June 30—686 million bushels, 17 per cent more than in the previous year. Wheat exports, including flour and macaroni products, totaled 500 million bushels; other grains and grain products, 186 million bushels.

The outlook for grain exports in 1949-50 is somewhat uncertain. Undoubtedly, large import needs will continue to exist in many countries but these do not necessarily assure markets for American grain. Four-fifths of total grain exports in the past year were to countries receiving financial aid from the United States, occupied areas, and ECA countries. This indicates that a large part of the recent high export volume is predicated upon the foreign aid programs which contemplate a gradual reduction in import requirements of the recipient areas. Domestic export volume will receive support in the year ahead as a result of moderately lower grain production in Canada and Europe.

Any falling off of demand, either domestic or foreign, will result in additional requirements for storage capacity. This is particularly important under present conditions with grain prices being supported. In these circumstances a weakening of demand will be characterized largely by reduced utilization rather than a fall in price.

CURRENT MEASURES TO EXPAND CAPACITY

Enactment of legislation early in July authorizing the Commodity Credit Corporation to undertake a nationwide grain storage program, followed promptly by announcement from the Secretary of Agriculture that the Government, through the CCC, would grant "distress" price support loans to farmers on wheat "stored" on the ground in the Southwest and in temporary shelters in more humid areas, pointed up the seriousness of the situation as well as the importance attached to storage as a means of "delivering" on the Government commitment to support grain prices.

In recent weeks, the CCC has called for bids for the construction of 50 million bushels of bin-type storage capacity at country delivery points. This will double the present capacity owned by this agency. In addition to the expansion of Government owned space, agreements are being developed with private agencies for the storage of grain in structures which can be adapted to that use. The CCC estimates that it needs to lease additional storage space for at least 100 million bushels in the Corn Belt.

Government loans for new construction are provided

(Continued on Inside Back Cover)

Public Housing Boom Ahead¹

Homebuilding and Finance Face Impact of New Federal Program

Final enactment of the long discussed and highly controversial *Housing Act of 1949* on July 15, promises to have a marked impact upon both the homebuilding industry and the numerous institutions and individuals which provide residential financing. The new legislation authorizes sufficient Federal aid to build an anticipated 810,000 dwelling units of low-rent public housing during the next six years. Provisions for slum clearance, urban redevelopment, community development, rural housing improvement, and vastly broadened housing research, in addition to authorization for a housing census in 1950, are contained in the newly enacted law. Also, the mortgage-insuring powers of the Federal Housing Administration (FHA) have been extended; the secondary mortgage market through the Federal National Mortgage Association (FNMA) has been expanded; and Federal statutes regulating member bank operations have been amended to permit broader investing and underwriting activities in housing bonds.

As in the earlier public housing legislation—the *United States Housing Act of 1937*—dual purposes for the new program are set forth in the recently enacted law. The first purpose is essentially social in that it stresses the need for acceptable minimum housing and general living conditions for all people. The second aim is more strictly economic, with emphasis laid upon the need for a continuing high level of activity in the construction industry because of the effects of this industry upon general business and employment levels. In the *United States Housing Act of 1937* the objective of stimulation of construction had first priority, and that of better housing to improve general welfare second, in reverse order from the bill just enacted. This changed emphasis,

no doubt, reflects the fact that general construction activity in the nation is continuing at an exceedingly high rate in contrast to depressed activity before the war.

The most far-reaching question concerning the effects of the new legislation upon the future level of general business is whether the additional expenditures for public housing will be countered by further decline in private housing expenditures. Unless this occurs, it seems likely that a high volume of residential building is assured for the longer-run future.

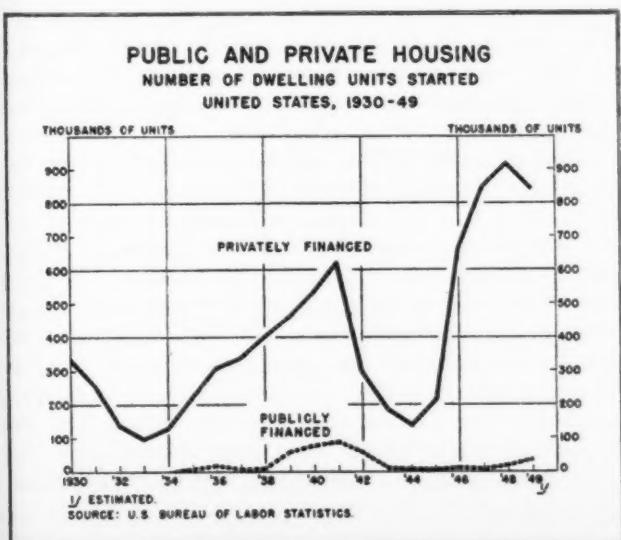
Quite obviously, the lag in time necessary for public housing operations to get started, even though many local agencies have plans which are well advanced, means that direct stimulating effects are not likely to be large in the immediate future. The official estimate calls for about 50,000 units to be started by mid-1950. Past experience suggests, however, that only a small fraction of this total will actually get under way in 1949, probably not more than 10,000 units.

However, the effects upon businessmen's expectations in the construction, finance, and building materials fields promise to be more direct and immediate. If a public housing program of the magnitude outlined is expected by private home builders and financial executives to have a sharply adverse effect upon demand for privately built homes—particularly of the single family type—speculative operations no doubt will be curtailed rather soon, with a consequent decline in private starts. However, if these businessmen believe that public housing will have no adverse effect upon their market—even possibly a belief that a building materials price increase may result from the augmented public housing program—speculative operations may increase rather than decline.

WHAT THE ACT PROVIDES

General Terms—The provisions of the *Housing Act of 1949* are essentially an extension and a modification of presently operating programs, as authorized by the *United States Housing Act of 1937* and the *National Housing Act*. In general, the changes relating to public housing: (1) give greater participation and veto power to local and state governing bodies, (2) encourage private financing and private enterprise building of the projects, (3) set higher cost limits for public housing construction, (4) allow for veterans' preferences in tenant selection, (5) make special provision for large families of low income, (6) reduce the maximum amortization period of housing bonds from 60 years to 40 years, and (7) provide for annual subsidies covering a

¹A discussion of plans and status of public low-rent housing in the Seventh Federal Reserve District will appear in a subsequent issue of *Business Conditions*.



vastly greater number of projects and housing units.

Low-Rent Housing—As previously stated, the six-year program of building—the time can be extended by further act of Congress—contemplates the starting of 810,000 dwelling units, no more than 10 per cent of which may be built in any one state. The Act recommends that these be started at the rate of 135,000 in each fiscal year beginning with July 1, 1949, but permits a range of from 50,000 to 200,000, depending upon the opinion of the President and the Council of Economic Advisers as to the probable effects of the program upon the construction industry in general. Whether this flexibility in fact will be important can only be known as the program develops. It is important to recall, however, that hesitancy of local participation thus far has acted more importantly as a deterrent to the total number of public housing units constructed than limits as set forth in the law.

In order that a Federally subsidized low-rent public housing project be erected in any community it is required that the local *governing body* shall by resolution: (1) approve the local housing authority's application for a preliminary loan, and (2) enter into an agreement with the local housing authority to provide all cooperation, which in practice means local tax exemption.

It is likewise necessary for the local housing authority to convince the Public Housing Administration (PHA) that there is a need for such low-rent housing which is not being met by private enterprise builders, and that the lowest rents charged for comparable units under private enterprise are at least 20 per cent higher than the highest rents contemplated for the proposed project.

Temporary Loans and Grants—If the foregoing conditions have been met, the local housing authority may apply for a *temporary loan* from PHA for the purpose of initiating development work on surveys, plans, land acquisition, or other preliminary work connected with a proposed housing development. These loans are to be paid back within 18 months or as soon as the permanent financing is carried out, and must not carry interest at less than the "applicable going Federal rate," now 2.5 per cent.

In the event that the land to be acquired is a slum or blighted area, the local housing authority, in addition to the temporary loan previously mentioned, may apply for a *grant* from the Housing and Home Finance Agency (HHFA) which may total as much as two-thirds of the difference between the gross cost of the land after it has been readied for construction and the appraised value for the intended use of the land.

Thus, the Federal grant-in-aid for slum clearance absorbs two-thirds of the cost of demolition, relocating streets, and other necessary work, with the local or state government standing the other one-third. The cleared land need not necessarily be used for public housing. In fact it may be used for any public or private purpose which conforms with a community plan. It is anticipated that eventually some slum-cleared land will be bought or leased for industrial and commercial purposes. HHFA grants for slum-clearance are author-

ized up to a total of 500 million dollars.

Construction of the Homes—Having acquired either vacant or slum-cleared land by means of loans and grants from the Federal Government, the local agency is then ready to let bids to private contractors for construction of the project. The normal maximum construction cost permitted by the new law is 1,750 dollars per room. Under certain conditions, however, the Administrator of the HHFA may permit the cost per room to go as high as 2,500 dollars. Nevertheless, the Act states that projects must not be "of elaborate or extravagant design or materials," and to assure that local housing agencies follow this practice, all general contracts for construction must be approved by the HHFA.

Financing the Project—Long-term financing is to be carried out where possible through the sale of bonds by the local housing authority to the public. These issues will carry exemption from Federal taxation as is the case with other municipals. However, PHA is authorized to buy local housing bonds up to a total of one billion dollars at the applicable going Federal rate.

In order to stimulate private financing it is provided that the annual contributions (subsidies) of the Federal Government shall be pledged as security for the bonds. If any local housing authority is in substantial default on its bonds for a particular project, it must either convey title to the project or deliver possession of it to the Federal Government, which in turn will reconvey the project to the local agency after the defaults have been corrected.

Federal Subsidy—Under the new Act a maximum of 308 million dollars is authorized to be paid as annual contributions by the Public Housing Administration to the local housing authorities so as to offset losses which might otherwise be incurred in operation. Actual rents to be paid by tenants will vary with localities, but in all cases, as previously stated, they must be at least 20 per cent less than the lowest rents on adequate private housing which is available. Also, the rent per family must be at least one-fifth of the family's income. When all expenditures for maintenance and debt service on the project are ascertained, and when the probable income from rents can be estimated, the Public Housing Administration will determine the amount of subsidy needed and enter into a contract with the local housing authority to pay this amount.

Local Subsidy—Before any low-rent project can be authorized the local governing body must have agreed to exempt the project from local taxes. In most cases this constitutes the local contribution (subsidy). Like the earlier legislation, however, the present Act provides that the project, in lieu of local taxes, may pay to the local government an amount equal to 10 per cent of the rents collected. The experience of many existing low-rent projects indicates that this payment often may be greater than the aggregate taxes previously paid by the owners of the former slum area, even though the earlier act stipulated a payment of five per cent of the rents rather than ten.

In general, the current expenditures of a low-rent

housing project would consist of (1) interest on bonds, (2) payments for serially maturing bonds, (3) maintenance costs, (4) project administration, and (5) payments in lieu of local taxes. Income would consist of shelter rents from tenants and annual contributions from the Public Housing Administration. The Federal subsidy cannot exceed the applicable going Federal rate plus two per cent on the development cost (including land acquisition) on the project. It is expected that in most cases the Federal subsidy will take care of the principal and interest charges on the bonds, leaving the balance of expenditures to be covered by the rents.

Banking Law Amended—Member banks are permitted by changes in Sections 5136 and 5200 of the U. S. Revised Statutes to purchase or underwrite the short-term or long-term securities or other obligations of local housing agencies without regard to the 10 per cent legal limitation contained in the general banking statutes.²

This provision makes it possible for banks to participate in public housing finance to a greater degree than heretofore, both from the standpoint of purchasing the bonds for investment and of underwriting their sale. It represents a further means of establishing a ready market for the local authority's bonds, as well as additional investment outlets for participating banks.

ECONOMIC SIGNIFICANCE OF THE PROGRAM

The many highly controversial questions concerning the probable economic results of the newly enacted public housing and slum clearance program fall into two principal groups: (1) influences upon the construction industry itself, and (2) influences upon finance, not only as respects mortgage finance *per se*, but also the broad effects upon the Federal budget and the municipal bond market.

Construction—Aggregate expenditures in the nation for all types of construction in the first six months of 1949 totaled nearly four per cent above the first half of 1948. This record exists in spite of a 12 per cent decline in expenditures for private residential construction which deficit has been offset by increases in privately financed construction of churches, schools, hospitals, and utilities, and by publicly-financed (chiefly state and local) schools, hospitals, highways, and other public works. In general it can be said that 1949 declines from the comparable months of 1948 in privately financed construction—down 300 million dollars—have been made up twofold by expanded public works.

Public housing and whatever other kinds of building may result from slum clearance are likely to incline toward the "heavy construction" type. At least, such contracts will have to be let to contractors who are organized to handle large projects of the "brick and steel" kind. Therefore, the small homebuilder—whether of the speculative or custom type—is not likely to feel that the program will help him directly. In fact, he has some reason to believe that a public housing de-

velopment of the size here contemplated, on the one hand, will undermine part of his potential market, and, on the other, prevent needed cost reductions by keeping prices of materials and labor at high levels. Reduced costs of private builders are essential in minimizing the need for still more subsidized public housing.

Public housing advocates maintain: (1) that the market they serve is not part of the potential market of private builders, and (2) that the total stock of housing would not be affected by slum clearance low-rent housing because new units would be accompanied by equivalent demolitions. If experience shows these claims to be well-founded, many businessmen may well adopt the attitude that the new Federal housing program assures a high level of construction, which in turn will have beneficial effects upon general business and employment. It should be pointed out, however, that all public housing under the expanded program will not be of the slum clearance kind, and therefore some net addition to the total housing stock probably will occur.

Finance—Aside from the general reaction which the public may have regarding a further increase in Government expenditures, the specific effects which the new housing program will have upon the residential mortgage and municipal bond markets are worthy of attention. The changes which the new legislation makes in the mortgage insuring provision of the *National Housing Act* do not appear to be very far-reaching, but the additional 500 million dollars authorized for secondary market (FNMA) purchases should have the effect of easing the tight portfolios of lenders now about "loaned up."

Quite significant are mortgage lenders' views on the probable effects of the public housing and slum clearance program on the private housing market generally. To the extent to which they foresee a net effect of lowered demand for private homes and apartments, their lending policies no doubt will become more selective and their appraisals more conservative. However, the slowness with which the public housing program seems likely to get under way will delay crystallization of many lenders' views. The present attitude appears to be one of caution and "wait and see."

A further major influence on finance will be the probable marketing during the next six years of a possible six to seven billion dollars of tax-exempt housing bonds. This volume is about 30 per cent of the estimated 19.5 billion dollars of currently outstanding tax-exempt bonds.

The bonds will be issued serially with maturities running from one to 40 years. Since the longer maturities—above 20 years—will exceed those of most outstanding tax-exempts, there is some reason to believe that an additional market must be forthcoming, or else the yields of these tax-exempted bonds may tend to equate the yields of long-term Governments on an "after taxes" basis. It is commonly held that maturities under 20 years may prove attractive to investors interested in the tax-exemption feature. Moreover, these shorter issues may sell at net yields considerably under even the higher grade state and municipal issues.

²For additional detail see *Washington Bulletin*, No. 4-49, American Bankers Association, July 13, 1949.

Improving Congressional Fiscal Machinery

Adoption of New Appropriations Procedures Likely

Among the various "economy" measures recently generated by realization of the large and increasing burden of Federal expenditures have been efforts to devise procedures to enable the Government to cope with the budget problem intelligently. The reports of the Hoover Commission and its task forces point out opportunities for reducing expenditures by reform and reorganization in the executive branch of the Government. The legislative branch has a counterpart to this in recent proposals for revising Congressional budgetary procedures.

The methods which Congress utilizes to process fiscal legislation, particularly appropriations, have long been considered too cumbersome to permit full Congressional control over and evaluation of the basic components of fiscal policy. Since the passage of the Budget and Accounting Act of 1921, the authority to review the budget requests of administrative agencies and departments and recommend appropriations has been concentrated in a single committee on appropriations in each House. The 1921 Act provided for Presidential responsibility for review of agency estimates and formulation of the Government's fiscal program. Subcommittees of the House Appropriations Committee consider the President's budget, hear testimony from agency representatives, and draft the appropriations bills, which rarely are altered by the full committee or amended by the House of Representatives. The Senate Appropriations Committee acts as a channel for appeals by the agencies from the House subcommittees with compromises between the Houses the usual solution.

While Congress thus exercises detailed control over expenditures, it had no machinery before 1946 for considering the general problems of relating total expenditures to total receipts or distributing the fiscal resources among the various functions of the Government. Today, with large and far-reaching Federal expenditures, this deficiency has become serious.

THE LEGISLATIVE BUDGET

An important attempt to improve the fiscal procedures is found in the Legislative Reorganization Act of 1946. Section 138 of the Act provides for joint meetings of the full appropriations and revenue committees of both Houses of Congress early in each session in order to draw up a legislative budget, that is, a statement of total estimated receipts and expenditures, with a provision for debt retirement or expansion in the event of an estimated surplus or deficit. There is also provision for debate on and adoption of a concurrent resolution based on the Joint Committee report. While this policy statement does not compel Congress to adhere to the

expenditure ceiling, it is devised to make it more difficult to overlook over-all fiscal consideration.

The legislative budget was originally conceived of as a device for reconciling expenditures with receipts, and for comparative analysis of the various expenditure categories.¹ In the three years of its existence Section 138 has accomplished somewhat less than its proponent had expected. The salutary effect of focusing public opinion on the appropriations process has not been sufficient to overcome the obstacles to achieving the goals of the reforms. The Joint Committee on the Legislative Budget in both sessions of the 80th Congress did not find it possible to make thorough analyses of the President's budget, due to both the brevity of the time allotted to them (about one month) and the lack of staff. Instead, the Joint Committee, in both 1947 and 1948, resorted to the expedient of altering the President's total expenditure and receipts estimates, lowering the former and raising the latter. In neither year did the Committee indicate in which functions the expenditure reductions would occur.

The lack of specific information in the Joint Committee reports enabled the legislative budget to be utilized as a vehicle for party programs. In 1947 a Senate amendment to the concurrent resolution introduced by the Joint Committee provided for an expenditure ceiling 1.5 billion dollars greater than that in the original, and the differences between the House and Senate were not resolved. In 1948 the concurrent resolution passed both Houses, but in neither years was the expenditure ceiling effective in reducing expenditures (see Table). In the first session of the 81st Congress the date of reporting

¹ Hearings Before the Joint Committee on the Organization of Congress, 79th Congress, First Session (March 13—June 29, 1945), pp. 273-275, 776, 780-781, 899-904.

RECOMMENDED AND ACTUAL BUDGET TOTALS FISCAL 1948 AND 1949

(In billions of dollars)

Item	President's Budget	Report of Joint Committee on the Legislative Budget	Actual
1948			
Estimated receipts	37.7	39.1	42.2
Estimated expenditures	37.5	31.5	33.8
Excess of receipts2	7.6	8.4
1949			
Estimated receipts	44.5	47.3	38.2
Estimated expenditures	39.7	37.2	40.1
Excess of receipts	4.8	10.1	-1.8

Note: Because of rounding, detail may not add to totals.

SOURCES: *The Budget of the United States, 1948, 1949, and 1950*, 80th Congress, First Session, House Report 35 on H. Con. Res. 20 (February 17, 1947); 80th Congress, Second Session, House Report 1361 on H. Con. Res. 147 (February 9, 1948). *Daily Statement of the United States Treasury*, June 30, 1949.

of the legislative budget was postponed from February 15 to May 1 and as the latter date approached the majority fiscal leaders introduced a resolution to suspend operation of Section 138 (S. Con. Res. 33). By August 19 of this year no further action had been taken.

The usual disinclination to abandon traditional methods and approaches probably bears a part of the responsibility for the failure of the legislative budget, along with deficiencies in timing and staffing. However, although the legislative budget provisions of the Legislative Reorganization Act have not proved successful, the current attention to other reform measures is evidence that Congress has not lost interest in improving its fiscal machinery and that further experimentation will be forthcoming.

CONSOLIDATION OF APPROPRIATIONS

The general consolidated appropriation bill, a subject of repeated proposals in the past, appears likely to become a reality in the near future. This bill, divided in to two titles, one for the military establishment and one for civilian functions, and subdivided into chapters corresponding to the existing 12 general appropriation bills, would facilitate Congressional recognition of the total magnitude of Federal expenditures and thereby make it possible to examine individual expenditure proposals in their relation to the over-all fiscal situation. At present it is often possible for the largest items of appropriations to evade scrutiny due to the absence of information early in the sessions as to the total expenditure picture. Senate Concurrent Resolution 18, introduced by Senator Byrd and co-sponsored by Senators Butler, Bridges, O'Connor, Knowland, Gillette, Ferguson, and Wherry, on which hearings have been concluded by a subcommittee of the Senate Committee on Rules and Administration, provides for general consolidated appropriations bills; it has received wide support, especially from Congressional fiscal leaders. House Appropriations Committee Chairman Cannon's endorsement is a notable example.

OTHER REFORM PROGRAMS

The omnibus appropriation bill is but one component of the various programs for the reform of Congressional fiscal procedures. One of the most important of these programs, in terms of both its content and its influence, is that of the Committee for Economic Development (CED), contained in its statement on national policy, "Tax and Expenditure Policy for 1949," issued in May 1949. The CED program emphasizes both Congressional reforms and improvements designed "to facilitate more informed public participation in the control of Government expenditures;" the latter include use of the cash-consolidated budget, clarifying policy issues by improved budget classifications, issuing a shorter budget statement, and defining public choices by spelling out future cost perspectives for existing long-run undertakings and proposed new programs. The CED, in regard to Congressional procedures, suggests "perfecting and implementing

the procedures implicit in the 1946 Act. The action of the present Congress in setting a later date (May 1) for agreement on the legislative budget, fixing a maximum limit on expenditures, accomplished a necessary first step. A second is to provide an adequate staff for appropriations work on the pattern of the staff of the Joint Committee on Internal Revenue Taxation. The third step would be to consolidate all appropriations bills into a single omnibus bill."

A more extensive program of innovations is that sponsored by Representative John W. Byrnes of Wisconsin, in a bill introduced on May 31, 1949 (H.R. 4909). The bill provides for: (1) performance budgets and appropriations, (2) reorganization of the legislative budget and the Legislative Budget Committee, (3) a Joint Committee on Appropriations, as a vital counterpart of the Joint Committee on Internal Revenue Taxation, (4) a new timetable for the submission of reports essential to sound budgeting and appropriating, and (5) a consolidated general appropriation bill.²

A performance budget, one in which the classifications are based on functions, activities, and projects, in the words of the Hoover Commission report on *Budgeting and Accounting* (p. 8) "would focus attention upon the general character and relative importance of the work to be done or upon the service to be rendered, rather than upon the things to be acquired." The second point, reorganization of the legislative budget, refers to provisions for replacing the existing 100-odd-member Joint Committee on the Legislative Budget with a 25-member committee composed of 10 members each from the Joint Committee on Internal Revenue Taxation and the proposed Joint Committee on Appropriations and five members from the Joint Committee on the Economic Report. Both new joint committees would have independent permanent staffs. The report developed by the Legislative Budget Committee would no longer have to be adopted by concurrent resolution, for the report itself would constitute a legislative budget. In addition, all new bills authorizing appropriations would be referred to the Joint Committee for estimating their future costs and effects on total expenditures.

The provision for a new timetable for the submission of essential reports—the President's three messages (State of the Union, Economic Report, and Budget), the reports of the Joint Economic Committee and the Legislative Budget Committee and that on the consolidated appropriation bill—is designed to enable Congress to give orderly consideration to these vital documents. This contrasts with the present overlapping in reporting.

Congress is not likely to act in this session on the Byrnes bill or any other program of comprehensive procedural reforms. However, the inadequacies of existing methods combined with current widespread interest in Government reorganization probably will result in a series of individual changes which in the course of several years may signify a major overhauling of the legislative processes.

²*Congressional Record*, Volume 95, Page A 3533, May 31, 1949.

Business Mortality Rises

Increasing Competition Hits Weaker Firms

The postwar upsurge in business population in the Seventh Federal Reserve District and the nation came to an end in 1948. Since then a moderate decline has been in progress, which promises to continue at least throughout the remainder of this year. Business failures are still only two-thirds of the prewar rate, but the rise in this District during the past year has been much sharper than in the country generally because of the somewhat later impact of the business downturn here. Failures in the Seventh District currently are running about 95 per cent ahead of a year ago, compared with 75 per cent in the nation. In recent months, however, this regional-national difference has been narrowing.

These developments in business population are largely the result of the widespread shift from sellers to buyers markets and are the almost inevitable sequel to the record expansion in new and untested business firms following the end of the war. Because numerous lines of business have not yet completed their readjustments to more normal market conditions, and competition is expected to intensify, further increases in business mortality can be anticipated, particularly among firms with weak managements, high costs, poor quality products, and unaggressive sales efforts. Business on the whole continues to be in excellent financial condition, with most of the difficulties to date arising among smaller firms inexperienced with competitive markets. No change in this condition is now foreseen.

BUSINESS POPULATION TRENDS

From the end of the war to the beginning of 1949, 1,700,000 new business firms were started in the United States and about 300,000 in Illinois, Indiana, Iowa, Michigan, and Wisconsin, which comprise the Seventh District states. It is well known that new firms have high mortality in their early years. Consequently many of these new businesses launched since the end of the war have been among the million which have closed their doors during the same period. The net increase (i.e. new entries less discontinuances) to date has been almost 700,000 for the nation and probably about 100,000 for the Seventh District states.

At the end of 1948 almost four million individual businesses were operating in the nation, and 700,000 in the District states. The peak in business births was reached in 1946. Discontinuances, however, did not exceed new starts until about the middle of last year. Subsequently, business mortality has outdistanced business births, and the total population in both the nation and this District now stands roughly one per cent under last year's record level.

Changes in numbers of businesses in a given industry

depend for the most part on the strength of demand for the product or service, ease of entry into the field, and the ability of existing establishments to expand. At one extreme, contract construction firms have increased 75 per cent during the postwar period, while those engaged in food processing have dropped four per cent. Certain manufacturing industries important to this District, e.g., electrical machinery, transportation equipment, and fabricated metals, have increased substantially in numbers to meet the huge demand for durable goods. However, listings by *Dun and Bradstreet* and the U. S. Bureau of the Census show that the total business population of the five District states has been slipping slightly since 1939 relative to the national total. While the actual number of firms has increased substantially in all District states, far greater increases have been recorded in the South, Southwest, and Pacific Coast areas. Only Michigan of the District group gained at a faster rate than did the nation as a whole.

Retailing dominates total business population figures and normally accounts for about 45 per cent of all business firms. The largest gains nationally in specific types of retailing since the war have been 52 per cent for automotive dealers, one-third for home furnishings stores, and over 90 per cent for appliance and radio outlets. Illinois, Michigan, and Iowa sales tax returns point to parallel retail developments in the Seventh District, with the exception that the total number of retailers in these states appears to have increased into the third quarter of last year while the nation peaked out in the second quarter.

UNDERLYING CAUSES

What were the reasons for the great increase in business population during the first three postwar years? The most important expansion factor was the sizable deficit, about 700,000 firms, existing on V-J Day in the number of establishments needed to provide properly for the production and distribution of civilian goods and services. During the war many firms were forced to shut down because key men were mustered into the service or because scarce materials became unobtainable for civilian use. These losses were made up in some lines as conversion to war production was completed, but most non-essential establishments had to wait for peace to resume business. In addition, a 10 per cent rise in human population and a sharp increase in business activity both influenced the numbers of business firms needed.

By the end of 1947, according to calculations of the U. S. Department of Commerce based upon human population and business activity, the immediate postwar deficit in business population had been eliminated. The net

increase in operating firms nevertheless continued, but at a much slower rate through the second quarter of 1948.

Prosperous postwar conditions and scarcities plus availability of needed funds made possible the fulfillment of the desire of many Americans to go into business for themselves and "be their own boss." The case of the GI's illustrates the spirit that helped bring the great influx of new firms after the war. At separation centers 25 per cent of all veterans expressed a desire to start up a small business. The actual number carrying through these intentions was considerably less, but nevertheless substantial.

Throughout the nation about 40,000 have taken advantage of the Veterans' Administration offer to guarantee or insure business loans up to \$4,000 if used to purchase real estate, and \$2,000 for non-real estate purposes. The Chicago VA office, covering the state of Illinois and three northern counties of Indiana, endorsed over 5,000 business loans from the start of the program through June 1949. Applications were accepted in large numbers in 1946 and 1947, but this year they have dropped to a mere trickle, with June bringing only 15 per cent as many as the same month two years ago. Counselors at VA offices feel that the early postwar desire to "start a little business of my own" has largely subsided.

SOURCES OF FUNDS

How did the new business firms obtain the funds needed to start and operate? Despite the supposed general lack of equity capital, it appears that the host of new enterprises were able to obtain adequate financing during the initial postwar years. Veterans and others accumulated substantial liquid savings during the war which could be invested in new firms, either directly or with other individuals interested in the venture. Banks, trade suppliers, and the Reconstruction Finance Corporation (RFC) also helped in many cases.

The Department of Commerce last year made an extensive survey of the progress made by wholesale and retail firms started during the period 1945-47. These businesses were estimated to have required seven billion dollars of initial capital. Retailers were found to have obtained 56 per cent of these funds from their own personal savings, 14 per cent from bank loans, 10 per cent from credit granted by suppliers, 7 per cent from capital stock, and 13 per cent from other sources, principally friends and relatives. For wholesalers the sources were similar except that capital stock and suppliers' credit were somewhat more important and personal savings less so. It is estimated that about two-thirds of all needed funds were provided by equity sources, either the owner's savings or through issuance of capital stock. By the end of 1947, these new trade firms were doing 25 per cent of total wholesale business and 15 per cent of all retail, and appeared to be increasing their share of the market.

Bank loans to business roughly doubled in the Seventh District during the three years following the end of the war. Investigation shows that the bulk of these loans went to established businesses owning substantial fixed assets. Many new firms, however, were able to accumu-

late sufficient financial strength during the period to qualify for bank credit in 1947 and 1948.

The security markets were not utilized to any great extent in obtaining funds for new postwar businesses. Common stock was usually purchased by the managers themselves or their relatives and friends. Some stock was offered indirectly as a gift to lenders who provided money on notes paying substantial rates of interest.

Life insurance companies which buy the great bulk of all corporate bonds are not ordinarily inclined to seek out new or small business enterprises as outlets for funds. Hence, this source has not proved to be important, with few new business firms having any bonded indebtedness.

DISCONTINUANCES AND FAILURES

Since last fall business failures¹ recorded by *Dun and Bradstreet* have been rising steeply. These figures account for only a small proportion of all firms ceasing operations, but they do provide a good indicator of trends in business population. Record low failure rates of four or five per 10,000 concerns were established for the District and the nation in 1945 and 1946. If the experiences of the first half of 1949 are duplicated in the second half, the rate will be about 35 per 10,000 firms for the entire year 1949. This would still be well below the level in almost any prewar year. The number of failures occurring in the Seventh District during the first six months of this year is up 115 per cent from the similar period of 1948, while the total for the nation has risen 80 per cent.

Although the Seventh District states account for almost 18 per cent of the total companies listed by *Dun and Bradstreet*, the number of failures during the first five months of last year was only 12 per cent of the national total. Despite the greater rise this year the proportion of total failures occurring in the District states during the comparable months of 1949 is still less than 15 per cent of the total. The current regional "share" of failures is also below the proportion found in the late thirties.

Further expected cutbacks by the heavy goods producers important to this District are likely to be felt more strongly by all business as the year progresses. Among the District states, Michigan has the highest failure record when compared with a year ago, having experienced a threefold increase, while Iowa has had the extremely low failure rate typical of predominantly agricultural states at the present time.

In this five state area, it appears that to an increasing extent the new failures are small firms. The average current liabilities per failure has dropped from about \$60,000 in the first six months of last year to less than \$40,000 currently. This same trend, however, has not been evident nationally.

During 1949 the heaviest failures relative to number of enterprises have been in manufacturing, both in this District and the nation. This group represents less than 10 per cent of the total business population, but has suf-

¹ Failures recorded by *Dun and Bradstreet* are defined as "firms involved in court or voluntary proceedings likely to result in loss to creditors." For every firm included in the *Dun and Bradstreet* figures there are probably three or four in financial difficulties which result in reorganization, change of management, or adjustment among creditors that are never recorded as "failures."

fered almost one-quarter of the failures.

The over-all "death rate" for business enterprises (for any reason) in 1948 was about 10 per cent of the number of firms operating at the beginning of the year, indicating an average potential business life expectancy of about 10 years. Discontinuances nationally last year numbered 371,000, up 27 per cent from 1947 and 64 per cent from 1946. Only a small proportion of these firms which withdrew from the field actually "failed" in a legal sense. About one-half, according to a Department of Commerce estimate, ceased operations simply because of retirement or illness of persons important to the enterprise. Most of the remainder are "economic failures" in that they did not provide a suitable return upon investment, and managers wound up the business as best they could.

CAUSES OF FAILURE

It is well known that some business firms fail in the best of times. "Unwise management" usually is charged with the responsibility. When recession comes a rash of failures always occurs. In this case the "business cycle" gets the blame.

In a sense the causes for all failures can be laid at the door of management, whether because of poor operating practices, excessive debt, inadequate working capital, over-expansion, sharp price declines, or lowered demand. Most enterprises, however, survive even the worst crises. Therefore, the process of natural selection is merely more intense in hard times. Shortcomings that are glossed over during periods of great prosperity are magnified now.

Experience shows that the typical firm involved in bankruptcy proceedings is likely to be small in size and less than five years of age. The large influx of new post-war firms, therefore, can be expected to inflate the failure totals in the months ahead. Almost 70 per cent of all firms which failed in 1948 had been formed after the war. Less than one per cent of these failing postwar businesses had 20 or more employees to start. In many cases they were organized hastily to take advantage of the reservoir of demand and purchasing power generated by the war, and often the managers were inexperienced and prone to bad judgment in purchasing and merchandising. Only a minimum of management was necessary so long as inflationary tendencies were dominant and inventory profits covered all but the worst errors. But these conditions have changed, and all managements are being put to a keen competitive test.

IMPLICATIONS FOR THE FUTURE

Further irregular rise in the failure totals can be expected through the remainder of the year. Even an upturn in general business conditions is not at all likely to restore the extremely low failure rates of recent years. Before the year-end the Seventh District will probably be contributing its full share to the national figures as a result of additional cutbacks in the durable goods industries. Although the business population does not appear to be greatly over-expanded for present levels of demand,

it is apparent that some further adjustments must be made to lower levels of activity in many lines. The impact, as in the past, is likely to be greatest upon the newest and smallest firms.

No serious wave of failures is now foreseen because, business in general, and especially the largest companies, have sufficient financial strength to withstand the moderate type of recession currently in progress. Excessive debt is not likely to be a great problem for most firms. Corporate capital structures, bolstered by large retained earnings, for the most part are well-balanced. Bank lending policies have been conservative. These factors, coupled with prevailing low interest rates tend to suggest that debt service problems will contribute less to bankruptcies in the period ahead than in previous downturns. Inventory depreciation also poses a much smaller threat because prices are less subject to drastic declines, and inventories already have undergone considerable downward adjustment.

Many of the newer firms are, and will be, pinched for cash necessary for efficient operations. Owners already have placed wartime savings in their businesses and that source is closed. In some cases, firms are being "milked" to maintain owners' living standards, despite sales and earnings declines. Some veterans who have received guaranteed loans to get started now find themselves with insufficient cash to keep operating. Approximately five per cent of veterans' business loans in the Chicago area have resulted in claims against the guarantee fund. Some further rise may be anticipated.

Although business shutdowns bring unemployment, sales of distressed merchandise, loss of proprietors' savings, and other serious repercussions, certain benefits in the form of increased efficiency are possible through "shaking out the weak sisters." However, a sharp increase in failures undoubtedly will include firms which deserve some sort of outside help. What kind of aid should be made available to them?

The Department of Commerce is launching a campaign to help small businessmen with their managerial problems. However, mere information will not salvage firms already deep in financial embarrassment. An injection of cash is their only hope for survival, and money from the normal sources may not be available. This problem was recognized during the early 1930's when Congress provided legislation enabling the Federal Reserve Banks and the RFC to make loans to businesses which appear to be good credit risks but cannot obtain funds elsewhere.

The long-run experience of the Reserve Banks and the RFC with loans granted during the last half of the thirties has been profitable, but good business during the war years was required to "bail out" many doubtful cases. Most of these loans were made at a time when business was at a low point, after which conditions steadily improved. Losses are likely to be greater if general conditions deteriorate while the loans are outstanding.

The current situation offers a challenge to private lenders to meet the needs of all deserving borrowers, and thereby lessen the demand for business lending through special agencies.

GRAIN STORAGE CAPACITY INADEQUATE

(Continued from Inside Front Cover)

to encourage farmers to increase storage capacity and accumulate grain stocks on their farms. In general, it is believed desirable to hold the accumulated grain stocks on or near the farms where they were produced so as to avoid unnecessary transportation costs and have them readily available for use when needed. The CCC will underwrite loans for five years at four per cent and up to 85 per cent of construction cost if made to farmers to construct new storage. In general, the loans could be repaid from payments earned by storing grain. Farmer cooperatives and other private businesses may also be encouraged to construct new storage facilities at both country and terminal locations although no substantial measures to attain this have been announced to date.

Storage payments are made to farmers to postpone delivery of grain to the CCC in settlement of price support loans, also to encourage farmers to increase storage capacity. Programs announced to date for 1949-50 apply to wheat, oats, barley, and corn.

Wheat on farms from the 1948 crop and under loan or purchase agreement, if resealed by July 30, was eligible for a storage payment of seven cents a bushel for the 1948-49 storage at time of resealing and an additional 10 to 11½ cents (depending on area) for continuing storage to April 30, 1950, if the grain is delivered to the CCC at maturity of the loans. A similar arrangement was offered for oats and barley except that no payment was made for the 1948-49 storage. The allowance for continuing storage until April 30, 1950, is eight cents a bushel for oats and 10 cents for barley.

Loans on 1948 corn can be renewed through October and a storage allowance of 10 cents a bushel earned by holding it on the farm. Corn under purchase agreements, if placed in acceptable storage, is also covered.

Loans and purchase agreements had been extended on 532 million bushels of corn by June 30, the cutoff date for the program. This was nearly twice the previous high of 302 million bushels placed under loan in 1939-40. At least 200 million bushels may be delivered to the CCC, following maturity of the loans on September 30, the remainder being largely resealed on farms. More than one-third of the corn under CCC loan and purchase agreement on June 30 was in Iowa, 192 million bushels. Illinois had the next highest amount, 114 million bushels.

Although there is general agreement that grain storage capacity should be increased, there is much less unanimity of opinion as to how much additional capacity is justified. The amount of grain storage space required depends, among other things, on the purposes for which grain is stored. Moreover, on the justifiable purposes of storage there are differences of view.

PURPOSE OF STORAGE CHANGES

Civilized man has always been confronted with the problem of adjusting seasonal and annual variations in food supply to his relatively uniform daily needs. Historically, this has been the primary purpose of grain stor-

age and still is of great importance. But this is only one of several objectives of present day grain storage.

Some expansion of storage capacity apparently is needed to obtain optimum seasonal distribution of large grain crops such as have been produced in recent years. This is indicated by exceptional price weakness at harvest time.

In addition, some expansion of capacity may be justified to improve the distribution of grain supplies over periods of several years. Some students of the farm economy maintain that rates of livestock production could and should be stabilized by carrying large reserve stocks of feed grains. Available information indicates that some progress could be made in this direction.

Tension in relations with the governments of other countries and the possibility of armed conflict provide another reason for carrying relatively large reserves of grain at this time as a part of our general stockpiling of strategic defense materials.

A further reason for storing grain, the reason which largely dominates the current situation, is to raise prices by withholding grain from consumption. This objective, of course, stems from the price support program for agricultural commodities.

OVERPRICING, A BASIC PROBLEM

The current chaotic situation with respect to grain storage results very largely from a confusing mixture of objectives. Of immediate concern is the provision of sufficient storage capacity to permit withholding from usual market channels of enough of the current and prospective grain supply so prices will reach support levels, the other purposes of grain storage receiving only secondary consideration.

Submerged for the present is the fact that establishing a specified price level as the dominant goal in a grain storage program makes much more difficult, if not impossible, achievement of the other objectives. Increasing storage capacity and accumulation of stocks is an inappropriate and, in the long run, ineffective means of supporting grain prices. Temporarily, the "surplus" can be "hidden" but for commodities in which production can be expanded the useful life of this measure will be very short indeed. If prices are to be established as goals and largely removed from their usual functions of guiding production and consumption, then measures must be developed which will effectively control production or consumption, or both. Carrying large reserve stocks may well be one part of the measures needed. But the storage program should be designed primarily to perform those functions for which it is adapted, namely, providing optimum distribution through time of available grain supplies. Performance of this function is complicated rather than eased by emphasizing storage as a price support measure.

This does not detract from the need for some increase in storage capacity for grains. Rather it emphasizes that factors other than the relationship of *market prices* to *support prices* should govern the amount, location, and type of new storage constructed.

SEVENTH FEDERAL



RESERVE DISTRICT

